Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFPH:[redacted]:POSTF 12557-02
[redacted]

date: June 25, 2002

to: [redacted]
Team Manager, [redacted]

from: [redacted]
Associate Area Counsel, LMSB

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subject: [redacted]
Related to: [redacted], Inc.
Disclosure Concerns--Research Credit Claims

On June 6, 2002, we provided our response to your request for advice concerning disclosure concerns related to the sharing of audit information from the separate examinations of [redacted] ("[redacted]") and [redacted], Inc. ("[redacted]") covering taxable years [redacted] through [redacted]. We advised that our advice was subject to post review by National Office disclosure experts to insure our response was consistent with Office policy and expressed the correct legal standards.

On June 20, we received a response from National Office attorneys. They confirmed our statement of legal standards for disclosure under the transactional exception of I.R.C. § 6103(h)(4). However, they recommended we revise our conclusions as follows:

1. Disclosure of the entire RAR is likely unnecessary as it would not "directly relate" to the resolution of an issue in the audit. While portions of the RAR might come within the exception, they recommend against disclosure in this case.

2. The Engineer's report should be reviewed by Counsel prior to disclosure to the Taxpayers to insure all aspects come with the standard of section 6103(h)(4).

We concur with the above recommendations. Accordingly, kindly associate this memorandum with our June 6, 2002, correspondence.

Please be advised that this writing may contain privileged information. Any unauthorized disclosure of the writing may have

an adverse effect on privileges such as the attorney client privilege. If disclosure becomes necessary, please contact this Office for our views.

I may be reached at [redacted], ext. [redacted], should you have any questions.

/s/ [redacted]

[redacted]
Associate Area Counsel, LMSB

6/25/02

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFPH:[redacted]:POSTF 12557-02
[redacted]

date: June 6, 2002

to: [redacted]
Team Manager, [redacted]

from: [redacted]
Associate Area Counsel, LMSB

subject: [redacted]
Related to: [redacted], Inc.
Disclosure Concerns--Research Credit Claims

You have requested our advice concerning the adequacy of a joint disclosure waiver agreement issued to the Service by the above referenced Taxpayers. The waiver (copy attached) concerns the sharing of audit information from the separate examinations of [redacted] ("[redacted]") and [redacted], Inc. ("[redacted]") covering taxable years [redacted] through [redacted].[1] For the reasons stated herein, the exceptions for disclosure contained in I.R.C. § 6103(h)(4)(B) and (C) permit the Service sufficient latitude to accomplish the purpose you have expressed. Consequently, we believe the Taxpayers' waiver to be ineffectual and should not be relied upon.

Facts

The Taxpayers were joint owners of two power plants during [redacted] through [redacted]--[redacted] Operating plant, [redacted] ("[redacted]"), and [redacted] Operating plant, [redacted] ("[redacted]"). According to the Taxpayers, each owned [redacted] percent of the [redacted] operations with [redacted], Inc., owning the remaining [redacted] percent. [redacted] is held completely by [redacted] and [redacted] as equal owners.

The legal form selected by the Taxpayers for holding their ownership interests in the two power plants in unclear. It appears that each Taxpayer reports the results of the plants'

[1] We understand that [redacted] examination may also include the taxable year [redacted].

financial activities on the basis of their proportionate ownership. No separate financial reporting for federal tax purposes is done by [redacted] or [redacted].[2]

The issue to be examined on audit is the federal tax credits for increasing research activities as defined by I.R.C. § 41("Section 41 Credit") for the activities at the [redacted] and [redacted]. Specifically, the question is whether the Taxpayers' reported expenses were incurred in connection with production projects sufficient to constitute "qualified research expenses" within the meaning of section 41(b).

[redacted] and [redacted] use the accrual method of accounting with a taxable year ended December 31. The Section 41 Credit arises from claims for refund filed by each Taxpayer for the taxable years [redacted] through [redacted]. Each CIC taxpayer is examined by a separate Service exam team.

The Taxpayers propose that the Service's examination be consolidated. In a letter dated [redacted] ("Waiver"), they "[redacted]" would be in the best interests of the parties. While somewhat vague concerning the nature of the information sharing, the Waiver goes on to state that the "[redacted]." The Taxpayers have been working with the exam teams to develop an agreed approach of statistical sampling. The Waiver was submitted in an effort to further facilitate that effort.

You have requested our assistance to evaluate the adequacy of the Waiver. It is your desire to accomplish the Section 41 Credit examinations by pooling resources to the extent possible.

Analysis

I.R.C. § 6103(a) generally prohibits Service employees from disclosing tax return and tax return information unless authorized by a specific exception in this section. Section

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[2] [redacted] Operating Corporation apparently filed a corporate federal income tax return, Form 1120, for [redacted] for some or all of the years. However, the return contains no financial reporting. The attachment to its [redacted] tax return states that it "[redacted]

6103(b)(2) defines return information very broadly to include data which is received by, recorded by, prepared by, furnished to, or collected by the Service with respect to a return. Clearly, the information obtained by the [redacted] and [redacted] exam teams in connection with the audit of the Section 41 Credit would be return information.

Section 6103(h)(4) permits the Service to disclose third party tax return information in judicial or administrative proceedings under certain narrowly defined circumstances. Specifically, under section 6103(h)(1)(B), a third party's tax return or return information may be disclosed in judicial or administrative proceedings only "if the treatment of an item reflected on such [third party's] return is directly related to the resolution of an issue in the proceeding." Under section 6103(h)(4)(C), a third party taxpayer's tax return information may be disclosed "if such [third party's] return or return information directly related to a transactional relationship between a person who is a party to the proceeding and the [third party] taxpayer which directly affects the resolution of an issue in the proceeding...." It is the position of the Service that an examination constitutes an "administrative proceeding" for purposes of these provisions. First Western Government Securities, Inc. v. United States, 796 F,2d 356, 360 (10th Cir. 1986); Nevins v. United States, 88-1 U.S.T.C. ¶9199 (D.Colo. 1984).[3]

It is our opinion that the item and/or transaction exceptions of section 6103(h)(4)(B) and (C) are applicable to the instant situation. The projects that are the subject of the qualifying research expense arise out of the [redacted] and [redacted] activities of which the Taxpayers are joint owners. The expenses that form the basis for the refund claims are an allocation to each Taxpayer of its proportionate share of expenses based on ownership. In all instances, the subject projects are the same.

The Taxpayers' interests in [redacted] and [redacted] are akin to joint venture arrangements. Congress, in providing examples of the item and transaction tests, specifically recognized the benefits of limited disclosure where common ownerships interests exist:

> The return or return information of a third party would be disclosed ... in the event that the treatment of an item reflected on his return is or may be relevant

[3] While not precedent, the analysis contained in CCA 200048039 (December 1, 2000) is especially persuasive.

> to the resolution of an issue of the taxpayer's liability under the Code. Thus, for example, the returns of subchapter S corporations, partnerships, estates and trusts may reflect the treatment of certain items which may be relevant to the resolution of the taxpayer's liability because of some relationship (i.e., shareholder, partner, beneficiary) of the taxpayer with the corporation, partnership, estate or trust.

S. Rep. No. 94-935, at 325 (1976).

We believe the issue development associated with the Section 41 Credit comes within the meaning of the section 6103(h)(4)(B) and (C) exceptions. Accordingly, facts developed by the examination team in one audit can be disclosed to the Taxpayer in the examination of the second audit. Our conclusion extends only to the activities surrounding the development of the facts and analysis necessary to examine the Section 41 Credit issue. It includes the Engineer's report as well as the RAR.[4] It does not apply to any matters following the conclusion of the audit--e.g., potential resolution of the Taxpayer's tax liabilities at exam, the protest, and/or appeals consideration.

Conclusion

I.R.C. 6103(a) generally prohibits disclosure of tax return and tax return information. Under the facts of the present case, however, the narrow item/transaction exceptions of section 6103(h)(4)(B) and (C) would permit disclosure of facts relating to the examination of the [redacted] and [redacted] Section 41 Credit issue in the audit of the two Taxpayers.

To the extent the Taxpayers' disclosure waiver is narrower than the law permits, it is ineffectual. To the extent it requests a "single audit", it should be ignored.

In light of the foregoing, we do not recommend you solicit

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[4] CCA 199949006 (August 19, 1999) presented a factually similar scenario. The CCA was presented with the question of whether the report of an IRS Economist analyzing the value of assets contributed by one taxpayer to a joint venture could be disclosed as a part of the examination of another taxpayer who also held an ownership interest in the joint venture. The CCA concluded that disclosure was permissible under both section 6103(h)(4)(B) and (C). As to the disclosure of the RAR, see CCA 200048039 (December 1, 2000).

any modifications to the Taxpayers' waiver. To the extent you seek additional written assurances, however, consideration should be given to securing a Form 8821, Tax Information Authorization. We recommend you contact this Office for further assistance should you utilize such approach.

This advice has been submitted to the National Office for 10 day post issuance advice review. We will advise you of any changes to our recommendations should they be forthcoming.

Please be advised that this writing may contain privileged information. Any unauthorized disclosure of the writing may have an adverse effect on privileges such as the attorney client privilege. If disclosure becomes necessary, please contact this Office for our views.

I may be reached at ([redacted], ext. [redacted], should you have any questions.

/[redacted]

[redacted]
Associate Area Counsel, LMSB

Attachment: As stated.